the consumer market, but the same content producers dominate. Broadcasters are poised to receive a substantial increase in their ability to distribute content with the transition to digital multicasting. The current single channel with be expanded by the granting of rights to use spectrum to broadcast up to six channels digitally. As such, there is growing concern that the same entities that dominate the traditional channels of physical distribution of video entertainment product will extend their dominance to the new Internet and digital distribution channels.

The nature and relationship between these channels has changed over time. Terms of art once applied have stuck, even though they may no longer technically describe the distribution channel.

Theatrical distribution of movies has been around the longest, with the commercial industry stretching back to the early part of the 20^{th} century. Television emerged in the 1950s and 1960s. Cable arrived in the 1970s and 1980s. Distribution of video tapes began in the 1980s and exploded with the advent of DVDs in the early 2000s.

Traditionally, television was divided between broadcast and cable to reflect the different means of delivery. Broadcasters sent signals over the air from TV transmitters (stations) that were licensed by the FCC. Cable signals were sent from a head end through a wire, the laying of which was franchised by a local entity. Today, although broadcast signals are still available over-the-air, most American households (80% to 90%) get the broadcast product through the cable wire or from satellites.

Prime time on broadcast TV was always a focal point of policy because of the huge audience and resources it commanded. Prime time was controlled by the networks, which also held licenses to operate TV stations in the largest markets. They created national networks by affiliating with independent license holders in markets where they did not hold broadcast licenses directly. The major networks – ABC, NBC and CBS, reach virtually every home in America. Fox is a national network as well, although it may be available in somewhat fewer homes.

Although cable has always been a subscription service, it split into two different distribution channels when pay cable services, like HBO, developed the ability to charge a premium for programming and basic cable became advertiser supported, mimicking broadcast television. Historically, one could draw a clear line between production of content by movie studios and exhibition – the presentation to the public of product – in theaters. The distinction breaks down with live television – the broadcast is simultaneously produced and distributed. Television also changes the nature of the exhibition from a public space to a private space, although it is still shared in the sense that programming is watched simultaneously, but separately, by large numbers of people. The sale/rental of videos (and the recording of programming) for home viewing (referred to as Home Video) extended the change from a public to a private experience by allowing people to choose when to watch.

ANALYTIC APPROACH: STRUCTURE, CONDUCT PERFORMANCE

The paper applies a framework of analysis known as the structure-conduct-performance paradigm (see Exhibit II-1), [16] which has been the dominant approach to industrial organization analysis for over three-quarters of a century. The premise is simple.

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[16] Scherer, F. M. and David Ross, Industrial *Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990); Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985).

The analysis seeks to identify the conditions that determine the performance of markets.[17] It starts with basic conditions.[18] On the supply-side these include factors such as technology, product durability, business attitudes and the legal framework. On the demand side factors such as price elasticity, cyclical/seasonal patterns, and purchasing methods are included. These interact with characteristics of the market structure,[19] such as the number

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[17] Id., p. 4.

> We seek to identify sets of attributes or variables that influence economic performance and to build theories detailing the nature of the links between these attributes and end performance. The broad descriptive model of these relationships used in most industrial organization studies was conceived by Edward S. Mason at Harvard during the 1930s and extended by numerous scholars.

Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985), p. 5, presents a similar view.

[18] Scherer and Ross, p. 5.

> Market structure and conduct are also influenced by various basic conditions. For example, on the supply side, basic conditions include the location and ownership of essential raw materials; the characteristics of the available technology (e.g. batch versus continuous process productions or high versus low elasticity of input substitution); the degree of work force unionization; the durability of the product; the time pattern of production (e.g. whether goods are produced to order or delivered from inventory); the value/weight characteristics of the product and so on. A list of significant basic conditions on the demand side must include at least the price elasticity of demand at various prices; the availability of (and cross elasticity of demand for) substitute products; the rate of growth and variability over time of demand; the method employed by buyers in purchasing (e.g. acceptance of list prices as given versus solicitation of sealed bids versus haggling); and the marketing characteristics of the product sold (e.g. specialty versus convenience shopping method).

[19] Scherer and Ross, p. 5.

> Conduct depends in turn upon the structure of the relevant market, embracing such features as the number and size distribution of buyers and sellers, the degree of physical or subjective differentiation prevailing among competing seller's products, the presence or absence of barriers to entry of new firms, the ratio of fixed to total costs in the short run for a typical firm, the degree to which firms are vertically integrated from raw material production to retail distribution and the amount of diversity or conglomerateness characterizing individual firms' product lines.

Exhibit II-1:

The Structure-Conduct-Performance Paradigm

BASIC CONDITIONS

Supply
Raw material
Technology
Unionization
Product durability
Value/Weight
Business attitudes
Legal framework
Price Elasticity

Demand
Price elasticity
Substitutes
Rate of growth
Cyclical and seasonal Character
Purchase method
Marketing type

↓

MARKET STRUCTURE

Number of sellers and buyers
Product differentiation
Barriers to entry
Cost structures
Vertical integration
Diversification

↓

CONDUCT

Pricing behavior
Product strategy and advertising
Research and innovation
Plant investment
Legal tactics

↓

PERFORMANCE
Production and allocative efficiency
Progress
Full employment
Equity

PUBLIC POLICY
Taxes and subsidies
International trade
Regulation
Price Controls
Antitrust policy
Information

SOURCE: Scherer and Ross, F. M., and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company: Boston, 1990), p. 5.

and the size of sellers and buyers, product differentiation, cost structures and vertical integration (the relationship of production and distribution), to determine the conduct of the market participants. The key types of conduct include pricing behavior, product strategy and advertising, and legal tactics.[20] Conduct determines performance, traditionally measured in terms of pricing and profits, but increasingly viewed as quality and the nature and speed of innovation.

One of the key features of the structure-conduct-performance paradigm is that it recognizes the importance of public policy. Policies, such as antitrust enforcement, regulation, or taxation and subsidization, can directly affect structure and conduct, thereby altering performance.

HORIZONTAL MARKET POWER

The characteristic of market structures that received most public policy attention is horizontal market power. The concern is that if markets become concentrated – i.e. where a few players have a large market share – competition is dulled. Rather than compete to produce the best product at the lowest price, one large entity may be able to set prices up or otherwise affect output, without a sufficient response from others to discipline such behavior. With small numbers of competitors, they may accomplish the same thing by consciously paralleling each other's behavior. Thus, the Department of Justice defines market power as

[20] Scherer and Ross, p. 4.

> Performance in particular industries or markets is said to depend upon the conduct of sellers and buyers in such matters as pricing policies and practices, overt and taciturn interfirm cooperation, product line and advertising strategies, research and development commitments, investment in production facilities, legal tactics (e. g. enforcing patent rights), and so on.

"the ability profitably to maintain prices above competitive levels for a significant period of time... Sellers with market power also may lessen competition on dimensions other than price, such as product quality, service or innovation."[21]

Pure and perfect competition is rare, but the competitive goal is important.[22] Therefore, public policy pays a great deal of attention to the relative competitiveness of markets as well as the conditions that make markets more competitive or workably competitive. Knowing exactly when a market is "too" concentrated is a complex question. The Department of Justice calculates an index called the Herfindahl-Hirschman Index (HHI) to categorize markets (see Exhibit II-2). This index takes the market share of each firm, squares it and sums it. It considers a market with an HHI above 1000 to be concentrated. This is the equivalent of a market with fewer than the equivalent of 10-equal sized firms. It considers a market with fewer than the equivalent of approximately 5.5-equal sized firms (HHI = 1800) to be highly concentrated. Markets with an HHI between 1000 and 1800 are considered moderately concentrated.

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[21] Department of Justice/Federal Trade Commission, *Merger Guidelines* (1997).

[22] Scherer and Ross, p. 16-17.

> In modern economic theory, a market is said to be competitive (or more precisely, purely competitive) when the number of firms selling a homogeneous commodity is so large, and each individual firm's share of the market is so small, that no individual firm finds itself able to influence appreciably the commodity's price by varying the quantity of output it sells... Homogeneity of the product and insignificant size of individual sellers and buyers relative to their market (that is, *atomistic* market structure) are sufficient conditions for the existence of pure competition, under which sellers possess no monopoly power. Several additional structural conditions are added to make competition in economic theory not only "pure" but "perfect." The most important is the absence of barriers to entry of new firms, combined with mobility of resources employed.

Exhibit II-2:
Describing Market Concentration for Purposes of Public Policy

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE (%)
	Monopoly	1 Firm with 65% or more	4250<	100
	Duopoly	2	5000<	100
		5	2000	80
HIGHLY CONCENTRATED	Tight Oligopoly		1800 OR MORE	
		6	1667	67
UNCONCENTRATED	Loose Oligopoly	10	1000	40
	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger* Guidelines, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration ratios.

Many economists describe markets in terms of the market share of the top four firms. Shepherd describes these thresholds in terms of four-firm concentration ratios as follows:[23]

> Tight Oligopoly: The leading four firms combined have 60-100 percent of the market; collusion among them is relatively easy.
>
> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

Although the overlap is not perfect, there is a close correspondence between these two approaches. A highly concentrated market is called a tight oligopoly.[24] A moderately concentrated market is called a loose oligopoly.

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[23] Shepherd, p. 4.

Monopsony Power

A second economic concept that plays an important part in the video entertainment product space is that of monopsony power. Monopsony power is the flip side of monopoly power. Monopoly power is the power of a seller to dictate prices, terms and conditions as a seller of goods and services to the public. Monopsony power is the power of downstream buyers of inputs to create products to sell to the public and to dictate the prices, terms and conditions on which they buy those inputs. If the upstream suppliers lack alternatives, they may be forced to accept terms that under compensate them or force them to bear extra risk. The downstream buyers have market power over the upstream sellers of the product. This can result in the production of fewer or inferior products for sale downstream.

Although monopsony has not been the focal point of much antitrust action, it is more likely in precisely the type of sector like the video entertainment product space, where inputs are specialized

> Monopsony is thought to be more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in small towns, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers.[25]

Vertical Integration and Leverage

A third key characteristic of many industries is the extent of vertical integration. In many industries the act of producing a product can be readily separated from its distribution and sale. Production is referred to as the upstream, distribution and sale are referred to as the

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[24] Shepherd, p. 4.
[25] Sullivan and Grimes, p. 138.

downstream. Vertical integration occurs when both activities are conducted by one entity. Because vertical integration involves the elimination of a (presumably market-based) transaction between two entities it has been the focal point of a great deal of analysis. Economic efficiencies are frequently claimed for vertical integration due to the elimination of transaction costs. Others fear inefficiency and potential abuse of the ability to leverage vertical market power that can result from excessive or unjustified vertical integration.

The classic concern is that distributors of content, who are also producers, favor their own content at the expense of the content of unaffiliated producers. Vertical integration may become the norm in the industry, making it difficult for unintegrated producers to survive. Vertically integrated entities may capture the market for inputs, making it difficult for independent entities to obtain the factors of production necessary to produce product. Also, with vertically integrated entities dominating a sector, reciprocity and forbearance rather than competition may become the norm.

CONCLUSION

The remainder of this paper documents the emergence of a vertically integrated, tight oligopoly in the video entertainment product space. It shows that when public policies that prevented the exercise of market power were relaxed or eliminated, the conditions for the exercise of market power were quickly created by mergers and acquisitions and changes in behavior. The industry became a vertically integrated, tight oligopoly. Vertical leverage was used to eliminate independent production of prime time content. Monopsony power was exercised to squeeze independent film production into a very narrow, niche space on basic cable channels.

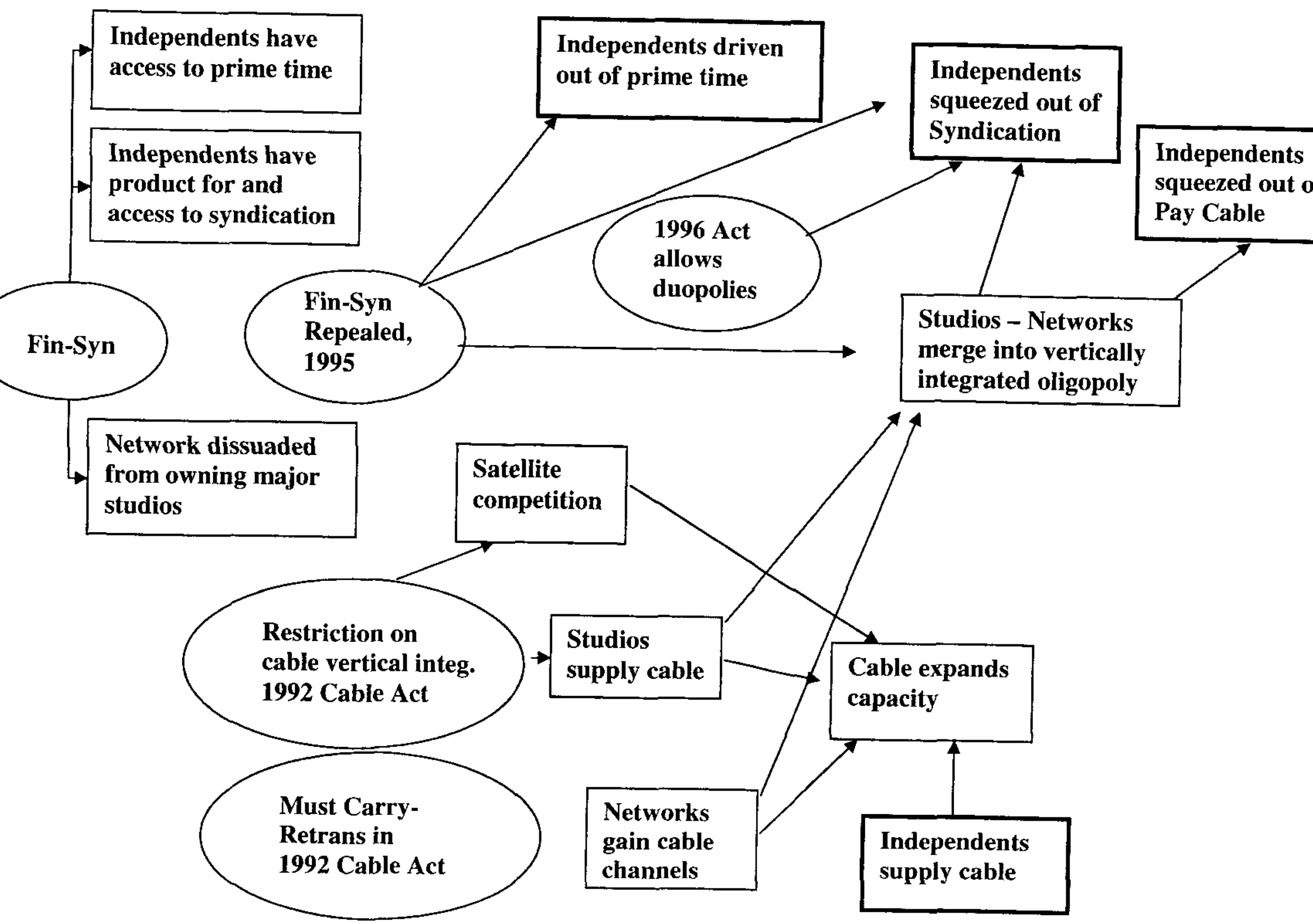
III. PUBLIC POLICY AND THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN VIDEO ENTERTAINMENT

THE REPEAL OF FINANCIAL AND SYNDICATION RULES TRIGGERS HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

At the end of the 1980s, policies to disperse ownership in broadcast television were in place. Though they had been debated intensely throughout the 1980s, the policies remained to limit holders of broadcast licenses to one to a market. These stations were known as O&Os (owned and operated). Holders of broadcast licenses could have O & O stations that reached no more than 25% of the nation's television households. The national broadcast networks were restricted in the amount of content that aired in prime time they could own and their participation in the syndication of non-prime time programming (the Financial and Syndication Rule). The broadcast networks filled out their national networks by entering into affiliation agreements with stations they did not own or operate. There were extensive rules that governed the relationships between the affiliated stations and the networks.

Exhibit III-1 identifies the key policy changes (ovals) and the structural and conduct changes that followed (rectangles) in the 1990s. The primary policy that triggered the vertical integration in the industry was the decision of the FCC to allow the Financial and Syndication Rules to lapse, rather than write rules that would pass court scrutiny. (see Exhibit III-1). In retrospect, it is quite clear that

Exhibit III-1:
The Impact of 1990s Policy Changes on Independents in the Television Market



the Financial and Syndication rules, which restricted the amount of broadcaster-owned programming in prime time, had a major effect on the diversity of not only the broadcast television market, but television in general. When the rules were eliminated in the mid-1990s, broadcasters moved to replace the lion's share of independent programming with content they produced. Self-dealing became the predominant mode of operation.

Ironically, the impact was more profound than the direct effect on prime time. At the time that the Fin-Syn rules were relaxed, restrictions on vertical integration in the cable industry were implemented. Cable operators were restricted in the percentage of capacity on their systems they could fill with programming they owned. In the Cable Consumer Protection Act of 1992 they were also required to make their own programming available to competing delivery systems (the program access rules). As a result of the improved access to programming, satellite competition, which had been anticipated in the 1984 Cable Act, finally increased its market share. Satellite was a digital technology with greater capacity than cable. The cable industry responded by deploying its own digital capacity. Thus, just as the broadcast space was closing, the cable space opened for the majors and independents. The studios, which had been prevented from integrating with broadcasters, funded and supplied programming for cable channels. Given their structure, they could not provide nearly all the programming that a 24/7 channel required. A substantial market for independent movie production opened up.

Majors and independents were not the only beneficiaries of the 1992 Cable Act. The Act also gave the broadcasters a wedge into the cable platform, with the must carry/retransmission rules. Cable operators needed to carry the major broadcast networks to make their basic subscription packages attractive to the public. The Cable Act of 1992 gave the broadcasters bargaining power over the cable operators. They could insist on a high fee for their national networks or they could negotiate for carriage of other programming. Must-carry and retransmission were government granted rights of carriage, means of ensuring access to audiences. The broadcasters chose to bargain for more channels on cable systems, rather than charge for their broadcast networks.

The 1996 Telecommunications Act reinforced this process. The Act allowed the FCC to lift the ban on horizontal concentration in the television industry. Broadcast licenses had been limited to one per entity in each market. The 1996 Act allowed the FCC to award more than one license per market after it had considered its impact on the industry. The FCC chose to allow duopolies in markets in which there would be at least eight "voices" in the market after the merger of two stations. Generally, the largest markets were opened to duopolies under the reasoning that diversity would be preserved in those markets.

For independents that sold product into TV syndication, this change had the opposite effect. By allowing the broadcast networks to own two stations in the most important markets – especially New York, Chicago and Los Angeles – a second major outlet was pulled into the tightening, vertically integrated core. The new owners of the second station now had a great deal of content of their own since, over the course of a decade, every major network acquired one of the major studios. Vertical integration became complete. Syndication was more difficult because access to the most important markets became much more difficult.

STRATEGIC MOVES

These changes did not take place instantaneously, but unfolded over a number of years for several reasons. When a policy change takes place, it frequently takes a period of time for regulators to implement legislated requirements. Parties will frequently litigate such changes and move slowly until the legal terrain is clear. Further, existing business relations must unwind. Contracts run their course and new models are developed. Finally, because many of these policies are highly visible political decisions, market participants try to avoid triggering a political reaction with extreme moves.

The 1990s policy changes triggered a series of acquisitions and product developments over the course of the decade that created a vertically integrated oligopoly in the television industry (see Exhibit III-2).

Exhibit III-2:
Major 1990s Acquisitions and Launches Involving Broadcasters in the Creation of the Vertically Integrated Video Entertainment Oligopoly

Year	Disney/ABC	Time Warner	Viacom/CBS	G.E-NBC	Fox
1993		Turner acquires Castle Rock & New Line			Fox acquires NFL rights
1994			Viacom acquires Paramount		
1995		Time Warner launches WB	CBS launches UPN		
1996	Disney acquires ABC	Time Warner acquires Turner			
1999			CBS acquires King World Viacom acquires CBS	NBC acquires 30% of Paxson	
2001					Fox duopolies LA, Minn. DC Houston
2002				NBC acquires Telemundo NBC duopolies result	Fox duopolies Chic. Orl.
2003				GE Acquires Universal	

Source: Columbia Journalism Review, *Who Owns What,* August 22, 2006.

Most directly, the networks could monopolize access to audiences in prime time broadcast television, foreclosing the streams of revenue that sustain production of all forms of content. Within a decade, the amount of programming on prime time owned by the networks increased dramatically, from 15% to around 75%. First the independents were excluded from prime time, and then the major studios were absorbed.

Each of the big three networks merged with a major studio and acquired cable programming over the course of the 1990s. Fox had taken a different path to vertical integration. After being rebuffed in an effort to acquire Warner studio, News Corp. acquired Twentieth Century Fox and a number of television stations in major markets, both in 1985.
Since the late 1970s, Twentieth Century Fox had been one of the least active of the major studios in providing television programming. Fox's focus through the 1990s would not be on original programming as traditionally defined for prime time. It would focus on sports in programming and broadcast duopolies.

Interestingly, Fox was vertically integrated but remained below the threshold for being subject to the Fin-Syn rules. For the big three networks who were subject to the rules, the repeal of Fin-Syn made mergers between networks and studios profitable, as self-supply was now allowed.

THE CURRENT STATE OF THE VIDEO PRODUCT ENTERTAINMENT SPACE

Vertical Integration

Within less than a decade after repeal of Fin-Syn and the passage of the 1996 Telecommunications Act, the process of vertical integration and horizontal consolidation was complete. This paper defines vertically integrated entities at the core of domestic video entertainment as the five firms that, in the past decade, have come to own major studios, broadcast networks and cable TV channels while holding television station licenses as well (see Exhibit III-3). The names are familiar to all in both the television and the theatrical movie space. All of the entities have a presence in each of the major video entertainment areas – network television, cable television and movie production. These firms account for five of the seven studios that produce motion pictures – known as the majors.

The depiction and data in Exhibit III-3 are for the early 2000s. While there have been some changes in the direction of deintegration that movement is not complete and its implications are not yet clear. CBS and Viacom have become partially separated. They still share the same Chairman (Sumner Redstone). Each of the two potential entities is vertically integrated on its own, with distinct production and distribution facilities. Similarly, Fox and Liberty remain precariously intertwined by substantial ownership of shares, although an exchange and separation of ownership in Fox and DirecTV may be in the offing. These evolving situations may change the landscape somewhat, but the distribution arrangement made by the separate entities would still reflect the legacy of vertical integration. Thus, we may see these entities unwind toward truer deintegration and independence, although the history of Liberty teaches that spin-offs and pull-backs are entirely possible. Moreover, whether these developments will constitute a true opening of the field to independents, or whether these entities will simply substitute contractual relationships to duplicate the integrated flow of content, also remains to be seen. Nor is it clear that the parts that have been broken up will not use their remaining partially integrated assets (production and distribution) to reintegrate across

Exhibit III-3:
The Vertically Integrated, Video Entertainment Oligopoly

Parent	Television Property	Cable/Satellite	Film Production
News Corp.	35 TV Stations reach 39% of U.S. Households 9 duopolies – NY, LA, Chic. Minn. D.C. Dallas, Phoenix Orlando, Houston Fox Network	Fox News, Fox Movie FX, FUEL, Nat. Geog. Speed, Fox Sports, Regional Sports, College, Soccer DirecTV	20th Century Fox, Fox Searchlight, Fox Television S, Blue Sky Studios
General Electric	28 TV stations reaching 34% of U.S. households 6 duopolies through Telemudo – NY, LA, Chic., SF, Dallas, Miami NBC Network 30% of Paxson	CNBC, MSNBC, Bravo, Sci-Fi, Trio, USA	Universal
Disney	10 TV stations reaching 24% of U.S. households ABC Network	ESPN, ABC Family, Disney Channel, Toon Disney Soapnet, Lifetime A&E	Walt Disney Touchstone Hollywood Buena vista Pixar Miramax
CBS/Viacom	17 TV stations reaching 39% of U.S. households CBS Network CW King World	Showtime MTV, Nickelodeon BET, Mick at Night TV land, Noggin Spike TV, CMT Comedy Central, Flix The Movie Channel Sundance	Paramount Paramount Home
Time Warner	CW Network	HBO, CNN, Court TV, Road Runner New York News 1 Time Warner Cable 14.5 million subscribers	Warner Bros. Studios, TV Home Video Domestic Pay-TV Telepictures, Hanna- Barbera Witt-Thomas,

Source: Columbia Journalism Review, *Who Owns What,* August 22, 2006.

the entire space.[26] The effects of any real de-integration, if it comes about, will play out over time.

Note that each of the entities has a presence in all of the key areas of video production and distribution. Each owns studios that produce video product for both television and theatrical release. Each has substantial ownership of television distribution. The four national broadcast networks are represented here. The broadcasters have substantial ownership of TV stations. The fifth entity, Time Warner, is a major cable operator. As a result of the recent Adelphia acquisition and exchange of cable systems with Comcast, Time Warner dominates the two entertainment centers in the U.S., New York and Los Angeles. It also has a share in the new broadcast network, CW, to which its production operations are providing content.

Each of the five also has substantial cable offerings. Indeed 24 of the top 25 cable channels, as measured by homes passed, are owned by these five entities. In terms of actual viewers, as opposed to homes where programming is available, these five entities account for the vast majority – as much as 85 percent -- of prime time viewing.

Horizontal Concentration

Reflecting this concentration of subscribers, viewers and facilities, these five, vertically integrated entities have come to dominate the domestic U.S. video entertainment product space (see Exhibit III-4). They accounted for about three quarters to four-fifths of the output of the video product in terms of writing budgets, programming expenditures, hours of prime time content, and domestic theatrical box office or video sales/rentals.

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[26] Grove, Martin A., "CBS' Moonves Smart to Eye Movies," *Hollywood Reporter.com,* July 7, 2006.

Exhibit III-4: Vertically Integrated Video Oligopoly Domination of Television and Movie Production and Distribution (Circa 2001-2003)

	TELEVISION							MOVIES/DVD (US Rev)	
	Subscribers*		Writing Budgets		Programming Expenditures		Share of Prime Time	Box Office	Video
	# Million	%	$ Million	%	$ Million	%	%	%	%
FOX/LIBERTY	1250	21	236	19	3803	9	3	11	10
TIME WARNER	925	15	206	17	7627	18	10	22	20
CBS/VIACOM	910	15	45	12	9555	22	28	8	7
ABC/DISNEY	705	12	132	11	6704	16	21	20	22
NBC/Universal**	720	12	159	13	3879	9	21	12	15
Subtotal	4315	75	772	72	31568	74	83	73	74
TOTAL	6000	100	1225	100	43212	100	100	100	100
HHI		**1179**		**1084**		**1226**	**1775**	**1213**	**1258**
FOUR FIRM CR		**63**		**61**		**65**	**70**	**65**	**67**

Notes and sources: * Subscribers includes broadcast and cable homes passed. ** Universal added to NBC to project post-merger market. Federal Communications Commission, In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming, CC Docket No. 00-132, Seventh Report, Tables D-1, D-2, D-3, D-6, D-7; Television Market Report: 2001 (Washington, D.C.: BIA Financial Network, 2001); Comments of the Writers Guild of America Regarding Harmful Vertical and Horizontal Integration in the Television Industry, Appendix A. Federal Communications Commission, In the Matter of Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992; Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996 The Commission's Cable Horizontal and Vertical Ownership Limits and Attribution Rules Review of the Commission's Regulations Governing Attribution Of Broadcast and Cable/MDS Interests Review of the Commission's Regulations and Policies Affecting Investment In the Broadcast Industry, Reexamination of the Commission's Cross-Interest Policy, CS Docket No. 98-82, CS Docket No. 96-85, MM Docket No. 92-264, MM Docket No. 94-150, MM Docket No. 92-51, MM Docket No. 87-154, January 4, 2002; Bruce M. Owen and Michael G. Baumann, "Economic Study E, Concentration Among National Purchasers of Video Entertainment Programming," Comments of Fox Entertainment Group and Fox Television Stations, Inc., National Broadcasting Company, Inc. and Telemundo Group, Inc., and Viacom, In the Matter of 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Cross Ownership of Broadcast Stations and Newspapers, Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets, Definition of Radio Markets, MB Docket No. 02-277, MM Dockets 02-235, 01=317, 00-244, January 2, 2003; Federal Communications Commission, Program Diversity and the Program Selection Process on Broadcast Network Television, Mara Epstein, Media Ownership Working Group Study 5, September 2002, pp. 26; David Waterman, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), pp. 21, 25.

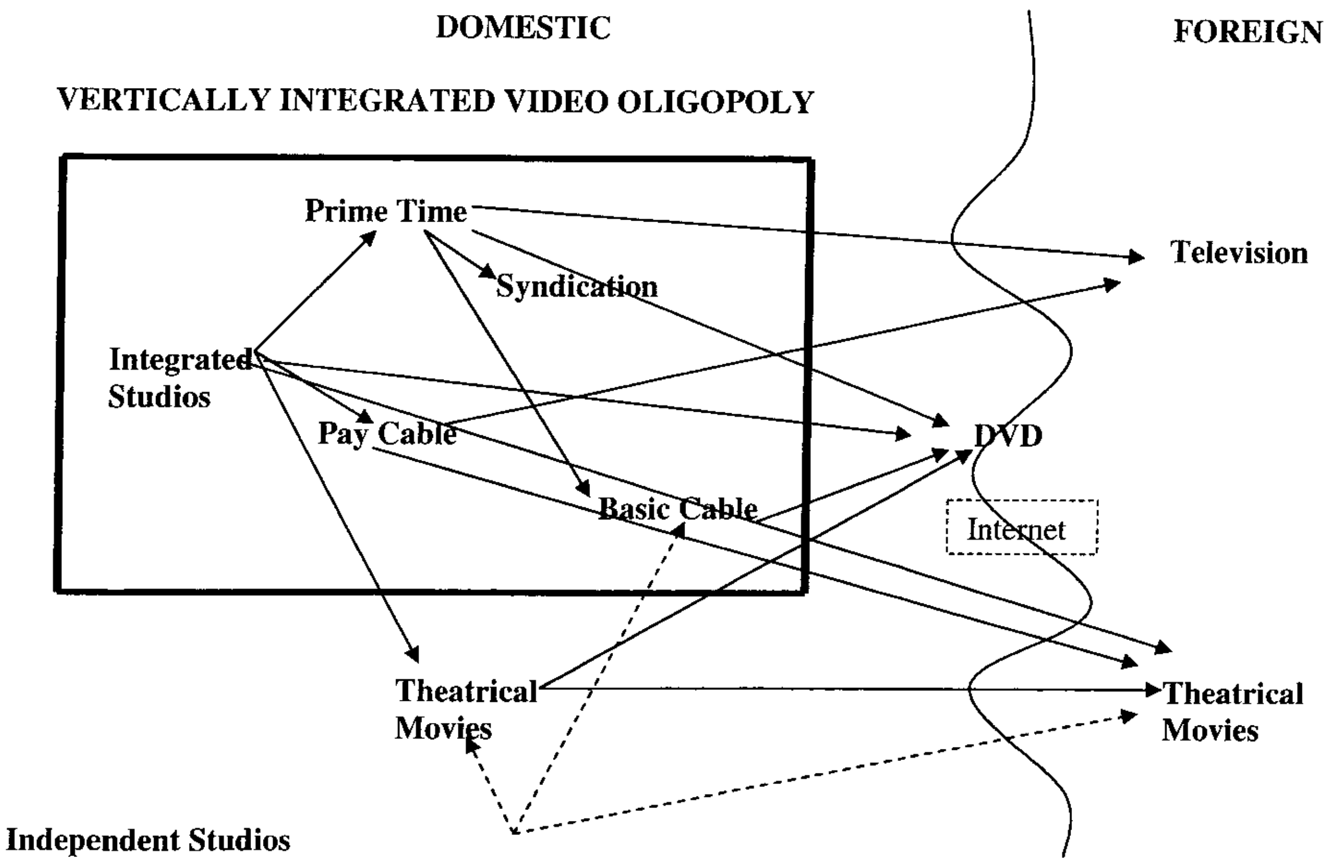
In each case, the HHI is in the concentrated range and the four firm concentration ratio is in the tight oligopoly range. The two potential changes in the sector noted above would not change this basic finding. Each of the measures of concentration would likely remain in the concentrated tight oligopoly range, but the identity of the leading firms might change a bit.

The broadcast space at the core of the vertically integrated oligopoly is extremely important to the overall market for video product (see Exhibit III-5). Where a program or film is placed in television space strongly affects not only its domestic revenues, but has a large impact on where it will be placed and what revenues it can earn in the international arena. By foreclosing the broadcast space, for both movies and series, the oligopoly core cripples independent producers and forces them into the cable arena, insofar as the independents desire to distribute over the television platform. The cable space, though, is a hostile environment as well, wherein the very same entities own the most attractive distribution channels in the space. Independents are forced into the least attractive cable channels on the least favorable terms.

THE CONDITIONS FOR THE EXERCISE OF MARKET POWER

Thus, the basic conditions for public policy concern about the potential exercise of market power are present. The empirical analysis demonstrates key economic characteristics of the video entertainment product space. It is a moderately to highly concentrated, tight oligopoly that is vertically integrated in production and distribution and exercises monopsony power – control and market power over the purchase of programming from independents.

hibit III-5:
cation in the Domestic Exhibition Space Strongly Influences Prospects in Foreign Markets



The remainder of this analysis presents evidence that market power has been exercised. In the process of creating the vertically integrated oligopoly, these entities behaved in a manner that created their market power through mergers, acquisitions and product development and exploited their market power through self-dealing, foreclosure of markets and imposition of onerous terms and conditions on suppliers. The key elements of the video entertainment product space include:

Market structure and market power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

Vertical Integration

- Barriers to entry increased by vertical integration.
- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream, unaffiliated product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

Monopsony Power

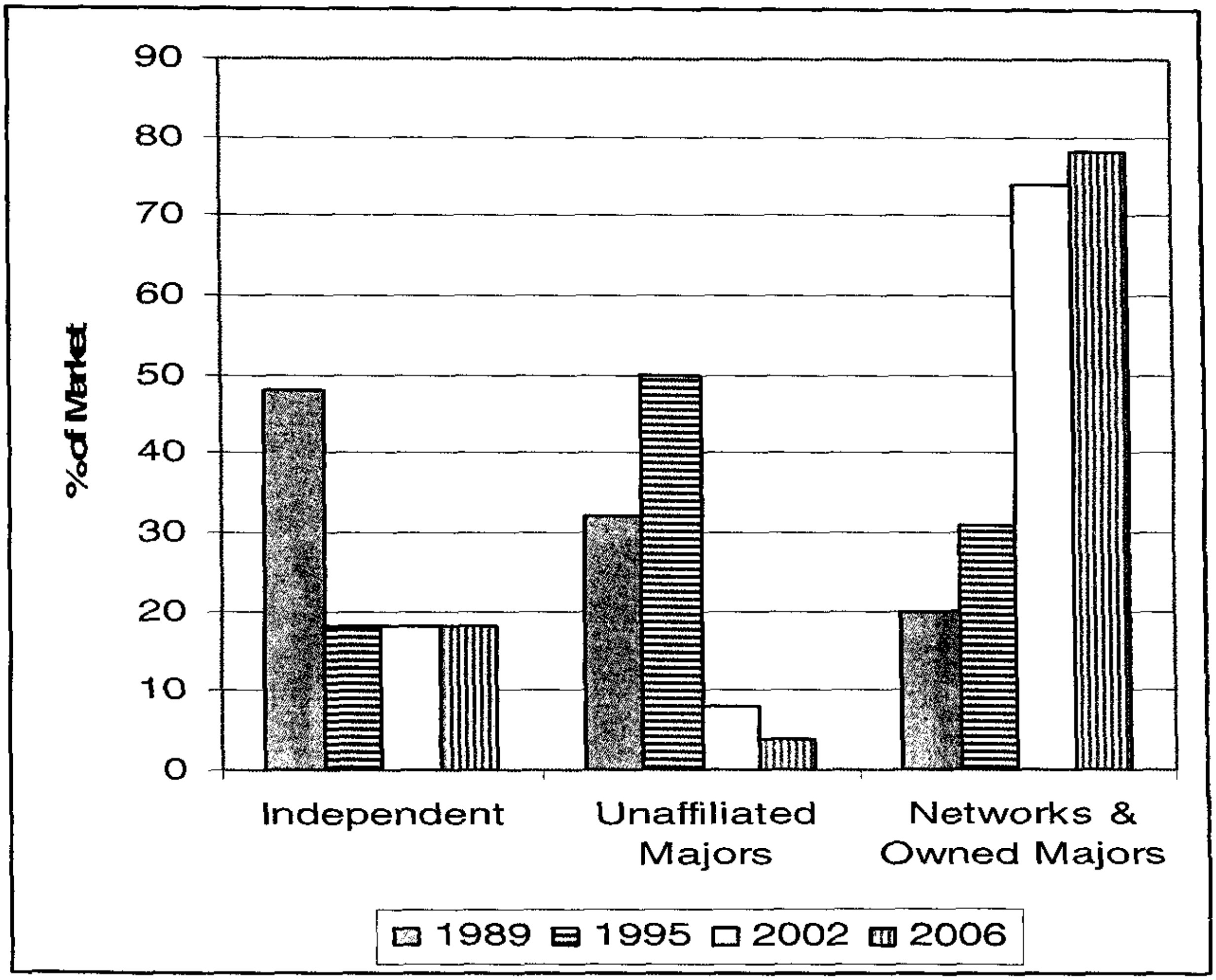
- The imposition of prices that squeeze unaffiliated producers and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

IV. DOMINATION OF THE TELEVISION PRODUCT SPACE

PRIME TIME ON BROADCAST/NETWORK TELEVISION

The central empirical fact at the core of the narrative of the 1990s is the dramatic and swift change in the ownership of prime time programming after the repeal of the Fin-Syn rules (see Exhibit IV-1). Studies of prime time programming just prior to the repeal of the

Exhibit IV-1:
Prime Time Market Shares



Source: 1989-2002 calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169; 2006 based on Baseline Research, *Fall Television Schedule: 2006-2007 Season.*

Fin-Syn rules find that the networks owned around 15 percent of shows aired in prime time. Major studios owned about one-third and independents accounted for about a half. Within five years, the role of the independents had been dramatically reduced – to less than one-fifth of the programming. Networks had grown to almost 40 percent. The major studios still accounted for around 40 percent. The mergers of the networks and studios followed and the vertically integrated entities came to dominate prime time, accounting for over three quarters of the programs. In 1989, fifteen entities produced 2 percent or more of the programming on prime time. By 2002, that number had shrunk to five. The programming produced by independents in 2006 was largely reality shows, not scripted programming, as had been the case in the recent past.

Traditional measures of market concentration used in economic analysis reinforce this observation. As Exhibit IV-2 shows, the prime time market moved very quickly from an unconcentrated competitive market (CR4=34%; HHI=541) to a tight oligopoly (CR4=74%) well up into the moderately concentrated range (HHI=1596). If the calculations are based only on series, i.e. excluding movies, the concentration is even greater. Within a decade after

Exhibit IV-2:
Concentration of Prime Time Programming

Year	Four Firm Concentration	HHI	Four Firm Concentration	HHI
All Prime Time Hours		*Series only*		
1989	35	541	40	703
1995	47	776	57	1165
2002	74	1596	84	2070

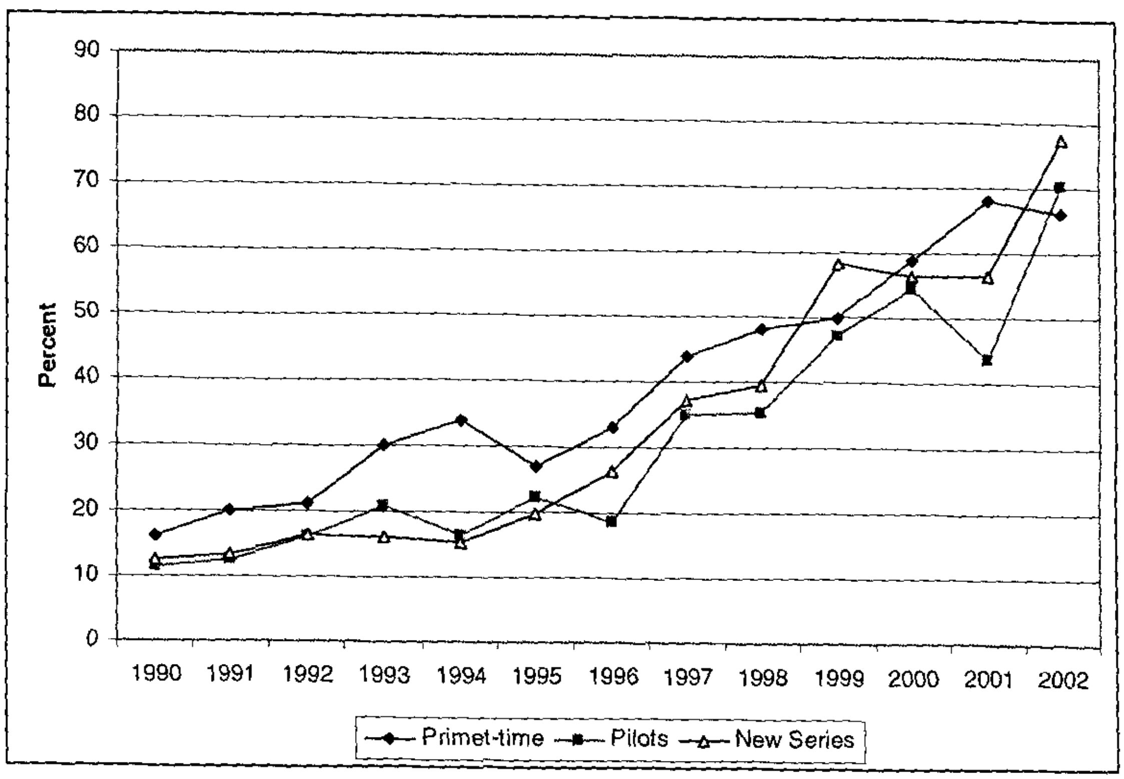
Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 169.

the repeal of Fin-Syn, the market was a highly concentrated (HHI=2070) tight oligopoly (CR4=84).

NEW SHOWS AND PILOTS

Exhibit IV-3 shows the pattern of ownership by the networks of prime time programming, new shows and pilots. We observe a modest increase in network ownership in the early 1990s, as the Fin-Syn rules were partially repealed, debated and litigated. With final repeal of the rules in 1995, we see a rapid and steady increase in network ownership.

Exhibit IV-3:
Network Ownership of Prime-Time Programming 1990-2002



Source: Calculated from Mara Einstein, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erbium, 2004), p. 171; William T. Bielby and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media*, 47: 4 (2003), p. 588.

The pattern has persisted, as an analysis of the 2006-2007 season shows (see Exhibit IV-4). The networks get over half of their programming internally. The four major networks also buy programming from one another. Overall, independents account for less than one-fifth of prime time programming. On the four major networks, the independents account for about one-seventh. The independent programming is generally reality shows, not scripted programming.

Exhibit IV-4:
Primetime 2006-2007 Programming
(Percent of Hours)

	Self-Dealing	Internal Big-5 Dealing	Sony	Independents
ABC-Touchstone	52	20	3	25
CBS-Paramount	57	38	0	5
NBC-Universal	67	14	5	14
FOX-20th Century	52	29	6	13
CW-Warner/ Viacom	53	0	7	40
Total	57	21	4	18

Source: Baseline Research, *Fall Television Schedule: 2006-2007 Season*

SYNDICATION

Syndication has been studied less than prime time, but the available data suggests a similar pattern (see Exhibit IV-5). Although there is less self-dealing, the five networks dominate the syndication market because of a large amount of internal dealing. Particularly interesting to note is the lack of recent independent shows in syndication. Having been forced out of prime time, independents simply do not have series to place as product in syndication.